

approval of the Administration, (1) interest-bearing securities, or (2) an irrevocable and unconditional commitment to finance the construction or acquisition of a new vessel in whole or in part by an obligor approved by the Administration in an amount equal to the amount by which the “net proceeds” exceed the cash or securities deposited in the fund.

(e) *Unauthorized deposits.* A deposit which is not provided for by section 511 of the Act shall, without unreasonable delay, be withdrawn from the fund and tax liability will be determined as though such deposit had not been made. (See §§ 287.10 and 287.24.)

#### **§ 287.14 Deposit of earnings and receipts.**

(a) *Earnings.* A citizen may deposit all or any part of earnings derived from the operation, within the scope of § 287.3, of a vessel or vessels owned either by himself or any other person, if such earnings are intended for construction or acquisition of new vessels. Such earnings may include payments received by an owner, as compensation for use of his vessel, from other persons by whom it is so operated. Earnings from other sources may not be deposited. The earnings from operation of vessels which are eligible for deposit are the net earnings determined without regard to any deduction for depreciation, obsolescence, or amortization with respect to such vessels.

(b) *Receipts.* Receipts from deposited funds, in the form of interest or otherwise, may be deposited.

#### **§ 287.15 Time for making deposits.**

(a) *Proceeds of sale or indemnification.* Deposits of amounts representing proceeds of the sale or indemnification for loss of a vessel or share therein must be made within 60 days after receipt by the taxpayer.

(b) *Earnings and receipts.* Earnings and receipts for the taxable year may be deposited at any time. (See § 287.14.)

#### **§ 287.16 Tax liability as to earnings deposited.**

Deposit in the construction reserve fund of earnings from the operation of a vessel or vessels, or receipts, in the form of interest or otherwise, with re-

spect to amounts previously deposited does not exempt the taxpayer from tax liability with respect thereto nor postpone the time such earnings or receipts are includible in gross income. Earnings and receipts deposited in a construction reserve fund established in accordance with the provisions of section 511 of the Act and the regulations in this part will be deemed to have been accumulated for the reasonable needs of the business within the meaning of part 1 (section 531 and following), subchapter G, chapter 1 of the Internal Revenue Code of 1954, so long as the requirements of section 511 of the Act and the regulations in this part are satisfied relative to the use of the fund in the construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels. For incurrence of tax liability due to noncompliance with the requirements of section 511 of the Act and the regulations in this part with respect to deposits in the construction reserve fund, see the provisions of § 287.23.

#### **§ 287.17 Basis of new vessel.**

The basis for determining gain or loss and for depreciation for the purpose of the Federal income tax with respect to a new vessel constructed, reconstructed, reconditioned, or acquired by the taxpayer, or with respect to which purchase-money indebtedness is liquidated as provided in section 511(g) of the Act, with funds deposited in the construction reserve fund, is reduced by the amount of the unrecognized gain represented in the funds allocated under the provisions of the regulations in this part to the cost of such vessel. (See § 287.18.)

#### **§ 287.18 Allocation of gain for tax purposes.**

(a) *General rules of allocation.* As provided in § 287.17, if amounts on deposit in a construction reserve fund are expended, obligated, or withdrawn for construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness of such vessels, the portion thereof which represents gain shall be applied in reduction of the basis of such new vessels. The rules

set forth below in this paragraph shall apply in allocating the unrecognized gain to the amounts so expended, obligated, or withdrawn:

(1) If the “net proceeds” of a sale or “net indemnity” in respect of a loss are deposited in more than one deposit, the portion thereof representing unrecognized gain shall be considered as having been deposited first.

(2) Amounts expended, obligated, or withdrawn from the construction reserve fund shall be applied against amounts deposited in the order of deposit.

(3) If any deposit consists in part of gain not recognized under section 511(c) of the Act, then any expenditure, obligation, or withdrawal applied against such deposit shall be considered to consist of gain in the same proportion that the part of the deposit which constitutes gain bears to the total amount of the deposit.

(b) *Date of obligation.* The date funds are obligated under a contract for the construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels, rather than the date of payment from the fund, will determine the order of application against the deposits in the fund. When a contract for the construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels is entered into, amounts on deposit in the construction reserve fund will be deemed to be obligated to the extent of the amount of the taxpayer's liability under the contract. Deposits will be deemed to be so obligated in the order of deposit, each new contract obligating the earliest deposit not previously expended, obligated, or withdrawn. If the liability under the contract exceeds the amount in the construction reserve fund, the contract will be deemed to obligate, to the extent of that part of such excess not otherwise satisfied, the earliest deposit or deposits thereafter made.

(c) *Illustration.* The foregoing rules are illustrated in the following example:

*Example.* (1) A taxpayer who makes his returns on the calendar year basis sells a vessel in 1963 for \$1,000,000, realizing a gain of

\$400,000. Payment of \$100,000 is received in March 1963 when the contract is signed, and the balance of \$900,000 is received in June 1963 on delivery of the vessel. The \$1,000,000 is deposited in a construction reserve fund in July 1963. In December 1963, the taxpayer also deposits \$150,000, representing earnings of that year. In 1964, he sells another vessel for \$1,000,000, realizing a gain of \$250,000. The sale price of \$1,000,000 is received on delivery of the vessel in February 1964, and deposited in the construction reserve fund in March 1964. In September 1964, the taxpayer purchases for cash out of the construction reserve fund a new vessel for \$1,750,000. To the cost of this vessel must be allocated the 1963 deposits of \$1,150,000 and \$600,000 of the March 1964 deposit. This leaves in the fund \$400,000 of the March 1964 deposit. The amount of the unrecognized gain to be applied against the basis of the new vessel is \$550,000, computed as follows: Gain of \$400,000 represented in the 1963 deposits, plus the same proportion of the \$250,000 gain represented in the March 1964 deposit (\$1,000,000) which the amount (\$600,000) allocated to the vessel is of the amount of the deposit, i.e., \$400,000 plus 600,000/1,000,000 of \$250,000 or \$150,000, a total of \$550,000. This reduces the basis of the new vessel to \$1,200,000 (\$1,750,000 less \$550,000).

(2) In 1965, the taxpayer sells a third vessel for \$3,000,000, realizing a gain of \$900,000. The \$3,000,000 is received and deposited in the construction reserve fund in June 1965, making a total in the fund of \$3,400,000. In December 1965, the taxpayer contracts for the construction of a second new vessel to cost a maximum of \$3,200,000, thereby obligating that amount of the fund, and in June 1966, receives permission to withdraw the unobligated balance amounting to \$200,000. To the cost of the second new vessel must be allocated the \$400,000 balance of the March 1964 deposit and \$2,800,000 of the June 1965 deposit. The unrecognized gain to be applied against the basis of such new vessel is that proportion of the gain represented in each deposit which the portion of the deposit allocated to the vessel bears to the amount of such deposit, i.e., 400,000/1,000,000 of \$250,000, or \$100,000 plus 2,800,000/3,000,000 of \$900,000, or \$840,000 making a total of \$940,000. The \$200,000 withdrawal is applied against the June 1965 deposit and the portion thereof which represents gain will be recognized as income for 1965, the year in which realized. The computation of the recognized gain is as follows: 200,000/3,000,000 of \$900,000, or \$60,000.

#### § 287.19 Requirements as to new vessels.

(a) *Requirements.* For the purposes of section 511 of the Act and the regulations in this part, the new vessel must be—